

OUTLOOK

FOR THE ECONOMY AND REAL ESTATE



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NOVEMBER 1985

Outlook For the Economy and Real Estate

The 3.3 percent increase in real GNP during the third quarter represents a marked improvement over the 1 percent growth rate of the first half of the year. However, at present, there is no evidence that this trend will continue through 1986. Most of the improvement in the third quarter growth was due to a temporary surge in auto sales and government purchases of defense goods, while the underlying trends in production and investment remained weak. It is, therefore, unlikely that the strong pace of spending experienced during the third quarter will be sustained. Already, auto sales have weakened in October as many incentive programs have expired. Most importantly, the funds needed for a continuation of the spending spree are becoming scarce as the savings rate has plunged to below 2 percent and household debt burdens have reached historic highs. Subsequently, growth in economic activity is expected to dip below 3 percent by year's end before slowing to near 2 percent through 1986. Despite expectations of below average growth, a recession is not likely as renewed growth in exports, an accommodating monetary policy, and the continued stimulus from federal deficit spending will keep the economy afloat.

The stagnation of the civilian unemployment rate in September despite a substantial rise in employment underscores the slowing in economic activity. By 1986, the increase in new entrants to the labor force accompanied by weaker economic growth could push unemployment back up to 7.5 percent. By 1987, however, stronger job growth should resume allowing the unemployment rate to decline to 7.3 percent.

The one bright spot has been the outlook for inflation. While consumer prices have been rising only modestly, producer prices continue to decline. Consumer price inflation is expected to increase 3.4 percent in 1985 and only 3.1 percent in 1986 as declining energy prices and slow growth put downward pressure on prices.

As the demand for credit weakens and inflation remains near 3 percent, long term interest rates should continue to trend downward through 1987. Short term rates should experience a modest upturn during the fourth quarter due to an increase in the supply of new Treasury issues when the debt limit is raised. By 1986, however, short term rates should resume their downward trend before increasing modestly in 1987.

Real Estate Markets

Home resale markets remained robust in September as mortgage interest rates on loans closed fell to six-year lows and the demand for homeownership continued to be strong. The September pace of resales--at a seasonally adjusted annual rate of 3.44 million units--was 26 percent above the 2.73 million unit rate recorded in September 1984. Home prices have outpaced inflation increasing at a 4.7 percent rate since last September. The outlook for resales remains favorable. As mortgage rates fall through 1986 and 1987, 3.3 million homes could be sold in 1986, and 3.4 million in 1987. Housing starts, after declining modestly in September, are also expected to increase through 1986 as indicated by the recent surge in building permits. In 1986, 1.8 million units are expected to be started.

The outlook for nonresidential construction remains mixed. Within commercial investment, construction of retail space should remain strong as increased housing spurs demand for nearby stores. Office construction, on the other hand, will weaken in 1986 as higher vacancy rates and oversupply dampen investment in this area.

Table 1
U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Historical		Forecast ¹						Actual		Forecast		
	85:2	85:1	85:4	86:1	86:2	86:3	86:4	87:1	1983	1984	1985	1986	1987
AGGREGATE ECONOMY													
Gross National Product (\$ billion)	1,853	1,916	1,926	2,021	2,080	2,102	2,135	2,226	1,900	1,863	1,888	2,085	2,341
Percent Change	4.5	6.7	0.5	5.5	3.0	1.1	1.5	4.2	7.7	19.8	8.2	9.0	8.3
Percent Change (without inflation)	1.9	3.1	2.0	1.9	1.5	1.0	1.0	2.5	3.7	8.8	2.4	2.0	3.0
Consumption	1,406	1,448	1,450	1,545	1,604	1,626	1,659	1,750	1,408	1,371	1,400	1,600	1,857
Durable	408	401	407	416	424	428	435	445	424	413	421	459	479
Nondurable	407	406	403	408	415	418	421	433	417	409	414	438	458
Services	407	407	408	417	428	429	429	435	417	412	419	437	459
Residential Investment	41	10.9	10.5	11.1	11.5	11.9	12.3	12.9	41.7	12.2	11.9	11.3	11.4
Nonresidential Investment	18.9	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6
Structures	18.9	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6
Equipment	18.9	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6	18.6
Exports	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2
Imports	16.7	16.7	16.7	16.7	16.7	16.7	16.7	16.7	16.7	16.7	16.7	16.7	16.7
Government Purchases ²	9.9	10.1	10.1	10.1	10.1	10.1	10.1	10.1	10.1	10.1	10.1	10.1	10.1
Consumption (% of GNP)	75.6	76.1	75.8	76.4	76.6	76.6	76.8	77.8	73.6	73.6	74.2	76.8	79.3
Residential Investment (% of GNP)	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Nonresidential Investment (% of GNP)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Structures (% of GNP)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Equipment (% of GNP)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Inventory Change (\$ billion)	17.8	18.2	18.2	18.2	18.2	18.2	18.2	18.2	18.2	18.2	18.2	18.2	18.2
Mfg. Capacity Utilization Rate (%)	80	80	79	79	79	79	79	79	79	79	80	79	79
Auto Sales (millions of units)	10.9	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3
Domestic (% of total)	75.6	75.6	75.6	75.6	75.6	75.6	75.6	75.6	75.6	75.6	75.6	75.6	75.6
Imports (% of total)	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4
Manufacturing Industrial Production (% change)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Common Market	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Japan	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Trade Deficit	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Value of the U.S. Dollar (Trillion Dollars)	1,117	1,117	1,117	1,117	1,117	1,117	1,117	1,117	1,117	1,117	1,117	1,117	1,117
Percent Change - Year Ago	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employment (million civilian nonfarm)	100.8	101.2	101.2	101.2	101.2	101.2	101.2	101.2	101.2	101.2	101.2	101.2	101.2
Percent Change	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Unemployment Rate (%) (1982 base)	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2	7.2
Personal Income per Household (average)	40,186	40,186	40,186	40,186	40,186	40,186	40,186	40,186	40,186	40,186	40,186	40,186	40,186
Percent Change - Year Ago (with inflation)	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Personal Income per Household (average)	11,400	11,400	11,400	11,400	11,400	11,400	11,400	11,400	11,400	11,400	11,400	11,400	11,400
Percent Change - Year Ago (with inflation)	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
Percent of Personal Income	18.8	18.8	18.8	18.8	18.8	18.8	18.8	18.8	18.8	18.8	18.8	18.8	18.8
Disposable Income per Household (average)	13,174	13,174	13,174	13,174	13,174	13,174	13,174	13,174	13,174	13,174	13,174	13,174	13,174
Percent Change - Year Ago (with inflation)	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Household Debt (% of total)	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7
Household Interest Payments (% of total)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consumer Price Inflation (CPI)	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Less National Product Inflation (GDP Deflator)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Personal Consumption Inflation	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Residential Construction Inflation	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nonresidential Construction Inflation	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Producers Price Inflation (PPI)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Compensation per Worker (% change)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Productivity (% change)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unit Labor Cost (% change)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Before Tax Corporate Profits (\$ billion)	111	111	111	111	111	111	111	111	111	111	111	111	111
Corporate Tax Liability	88	88	88	88	88	88	88	88	88	88	88	88	88
After Tax Profits	111	111	111	111	111	111	111	111	111	111	111	111	111
Inventory Valuation Adjustment	1	1	1	1	1	1	1	1	1	1	1	1	1
Capital Consumption Adjustment	1	1	1	1	1	1	1	1	1	1	1	1	1
Profits from Current Production (with IVA, ICA)	111	111	111	111	111	111	111	111	111	111	111	111	111
Adjusted for Inflation (85 = base)	111	111	111	111	111	111	111	111	111	111	111	111	111
Percent Change - Year Ago	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2
Per Unit of Output (% of GNP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Effective Corporate Tax Rate (%) (1982)	78	78	78	78	78	78	78	78	78	78	78	78	78
Federal Tax Receipts (unified basis)	828	828	828	828	828	828	828	828	828	828	828	828	828
Percent of GNP	44.4	44.4	44.4	44.4	44.4	44.4	44.4	44.4	44.4	44.4	44.4	44.4	44.4
Federal Expenditures (unified basis)	938	938	938	938	938	938	938	938	938	938	938	938	938
Percent of GNP	50.6	50.6	50.6	50.6	50.6	50.6	50.6	50.6	50.6	50.6	50.6	50.6	50.6
Surplus or Deficit (unified basis)	-110	-110	-110	-110	-110	-110	-110	-110	-110	-110	-110	-110	-110
% of GNP	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9	-5.9
% of Personal Savings	78.7	78.7	78.7	78.7	78.7	78.7	78.7	78.7	78.7	78.7	78.7	78.7	78.7
% of Net Domestic Savings	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4

111 Includes personal contributions for social insurance.

122 Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc. Assumptions and simulations by Dr. JACK WILLIAMS, Dr. R. NATHAN, and JAMES W. MURPHY.

Special Supplement

The Continuing Saga of Tax Reform

Yet another tax reform proposal has surfaced in the Nation's capital--the Rostenkowski proposal. This plan for sweeping overhaul of our tax laws was prepared by the staff of the Joint Committee on Taxation at the request of Congressman Rostenkowski (D-IL), Chairman of the House Ways and Means Committee, and is serving as the basis for the mark-up of a tax reform bill in the Committee. We will present our analysis of the original proposal, however, it should be noted that when and if a tax bill is sent to the floor of the House it will likely be quite different than this original proposal.

Conceptually, the Rostenkowski proposal is very similar to the Reagan proposal introduced last May. Each would cut personal and corporate tax rates while limiting or repealing many personal and business deductions so as to raise roughly the same amount of revenue as current law. The net impact of these changes is a cut in personal taxes financed through an increase in taxes on investment, particularly long-life assets such as real estate. As a result, there is a shift in the composition of GNP toward consumption and away from investment. In the long run the effect of the lower level of investment compounds and results in slower growth of the economy and lower living standards for the typical family.

Owner-Occupied Homes

Table 1 presents a comparison of the provisions of current tax law which determine an individual's federal tax liability and the after-tax cost of both owner-occupied principal residences and second homes held for personal use with those same provisions under the Reagan and Rostenkowski proposals. Current law is expressed as it will be in 1986 when the zero bracket amount (ZBA) or standard deduction, exemptions, and tax brackets are indexed for inflation.

Under current law there are 14 personal marginal tax rates ranging from 11 percent to 50 percent. Under both the Reagan and Rostenkowski proposals there would be three personal marginal tax rates, 15 percent, 25 percent, and 35 percent, however, the taxable income brackets are somewhat different. The Reagan proposal would raise the taxpayer, spouse, and dependent exemptions from the current law \$1,080 to \$2,000 while the Rostenkowski proposal would raise those exemptions to \$1,500. The Reagan proposal would raise the ZBA or standard deduction for joint returns from the current \$3,670 to \$4,000 while the Rostenkowski proposal would raise it to a base of \$6,000. Under the Rostenkowski proposal the standard deduction would be raised by \$500 for each dependent, raising the standard deduction for a joint return with two dependents to \$7,000.

Table 1

Comparison of Individual Income Tax Provisions
Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
PERSONAL MARGINAL TAX RATES	14 rate brackets from 11 to 50%	3 rate brackets 15%, 25%, 35%	3 rate brackets 15%, 25%, 35%
EXEMPTIONS			
Self, spouse	\$1,080	\$2,000	\$1,500
Dependents	\$1,080	\$2,000	\$1,500
Elderly	\$1,080	Credit	Repealed
Blind	\$1,080	Credit	Repealed
ZERO BRACKET AMOUNTS			
Single	\$2,480	\$2,900	\$3,550 ^{1/}
Joint	\$3,670	\$4,000	\$6,000 ^{1/}
Heads of Household	\$2,480	\$3,600	\$4,275 ^{1/}
INDEXED RATE BRACKETS, EXEMPTIONS, AND ZBA	Yes	Yes	Yes
PERSONAL DEDUCTIONS			
Mortgage Interest			
Principal Resi- dence	Yes	Yes	All personal interest deductions are limited to the greater of 1) interest on debt secured by principal resi- dence, or 2) \$20,000, plus passive invest- ment income. (Expanded def- inition of in- terest subject to limit. ^{2/}
Secondary Resi- dence	Yes	Treated as other personal interest.	See above.
Other Personal interest	Yes Investment interest limited to \$10,000 plus investment income.	Limited to \$5,000 plus passive invest- ment income. (Expanded defini- tion of interest subject to limit. ^{2/}	See above.

Table 1 (cont'd)

Comparison of Individual Income Tax Provisions
Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Real Property Taxes	Yes	No	Partially ^{3/}
Personal Property Taxes	Yes	No	No
State and Local Income Taxes	Yes	No	Partially ^{3/}
State and Local Sales Taxes	Yes	No	No
Medical Expenses	Yes, above 5% of AGI	Yes, above 5% of AGI	Yes, above 5% of AGI
Charitable Contributions	Yes, for itemizers and nonitemizers.	Deductible for itemizers but not for nonitemizers.	Deductible for itemizers but not for non- itemizers
Miscellaneous Deductions	Yes, for item- izers only	Yes, above 1% of AGI for itemizers and non-itemizers	Yes, above 1% of AGI for item- izers only
Two-Earner Deduction	Yes, 10% of lower salary	No	No
Child Care Credit	Yes	Yes	Yes, increased
FRINGE BENEFITS			
Health Insurance	Not taxed	First \$120 of premiums per year for individual coverage and \$300 for family coverage taxed.	Premiums <u>above</u> \$120 per month for individual coverage and \$300 per month for family cov- erage would be taxed.
Group-Term Life Insurance Premiums	Premiums for insurance over \$50,000 taxed.	Premiums for insurance over \$50,000 taxed.	Taxed
Dependent Care Assistance	Not taxed	Not taxed	Taxed

Table 1 (cont'd)

Comparison of Individual Income Tax Provisions
Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
OTHER INDIVIDUAL ITEMS			
Rollover of Capital Gains on Principal Residence	Capital gain tax deferred if seller purchases another residence costing at least as much as the one sold within two years.	Same as current law.	Same as current law.
One-time Exclusion on Capital Gains on Principal Residence	One-time exclusion of gain up to \$125,000 on sale of principal residence for taxpayers 55 or older.	Same as current law.	Same as current law.
Income Averaging	Yes	No	No
MUNICIPAL BONDS			
Mortgage Revenue Bonds (MRBs)	Tax-exempt, volume restrictions.	Taxed	Tax-exempt, with greater targeting toward lower income individuals and more restrictive volume limitations.

^{1/} These amounts are raised by \$500 for each dependent and for elderly and blind taxpayers.

^{2/} Included in the definition of interest subject to limitation is the taxpayer's share of all interest expense of S corporations in which the taxpayer is not actively engaged in management and the taxpayer's distributive share of all interest expense of limited partnerships in which the taxpayer is a limited partner.

^{3/} Allowed deduction would be the greater of \$1,000 for joint return, \$500 for unmarried taxpayers, or the amount in excess of 5% of AGI.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

While the impact of these changes is to lower tax liability, another impact is to raise the after-tax cost of owner-occupied homes by reducing the value of itemized deductions. The reduction in marginal tax rates directly reduces the value of all itemized deductions so that a given dollar amount of deductions results in a reduced amount of tax savings. For example, where \$1 of itemized deduction results in \$.25 of tax savings with a 25 percent marginal rate, tax savings are reduced to \$.15 with a 15 percent marginal rate. Increasing the ZBA or standard deduction also reduces the value of a given dollar amount of itemized deductions since it is the amount of such deductions above the ZBA which reduces taxable income and results in tax savings. Finally, increasing the value of exemptions tends to reduce the value of itemized deductions since, for a given level of gross income, larger exemptions result in lower taxable income and so are likely to result in a lower marginal tax rate.

In addition to reducing their value, both the Reagan and Rostenkowski proposals would reduce the dollar volume of deductions by repealing or limiting several currently allowed deductions. Under current law taxpayers are allowed unlimited deductions for interest paid on mortgages, auto loans, and other consumer interest while investment interest (interest on loans to purchase stocks, bonds, land and other so-called passive investments) is limited to \$10,000 plus investment income. Under the Reagan proposal deductions for mortgage interest on a principal residence would remain unlimited. However, all other personal interest deductions would be limited to \$5,000 plus investment income. The interest subject to this cap would include mortgage interest on a second home held for personal use, interest on auto loans, education loans, credit card balances, and investment interest. Further, a limited partner's pro rate share of the interest expense of a limited partnership would be included in the definition of investment interest. Currently, this limit on other personal interest deductions would not be binding for the majority of taxpayers. Average non-mortgage interest deductions for itemizing taxpayers with gross incomes of \$21,500, \$36,000, and \$64,000 are roughly \$800, \$1,100, and \$2,100, respectively. However, this interest deduction limit could be seriously binding for taxpayers who are paying interest on a mortgage to purchase a second home held for personal use. Moreover, this interest deduction limit would get progressively more restrictive over time as the \$5,000 limit is not indexed for inflation or fluctuations in interest rates.

The Rostenkowski proposal would limit deductions of all personal interest, including mortgage interest on a principal residence, to the greater of interest on debt secured by the taxpayer's principal residence or \$20,000, plus investment income. As with the Reagan proposal a limited partner's share of the interest expense of a limited partnership would be included in the definition of investment interest. Again, this formula would not limit interest deductions for the majority of taxpayers at current interest rates and home prices. For example, a taxpayer with a gross income of \$64,000 who purchased a \$150,000 home with a 20 percent downpayment and a \$120,000 mortgage with a 13 percent interest rate would have mortgage interest of about \$15,600 plus non-mortgage interest deductions of about \$2,100 for a total of \$17,700. As with the approach in the Reagan proposal, the Rostenkowski proposal would get more restrictive over time as home values rise and during periods of high interest rates since the \$20,000 figure is not indexed for inflation or interest rates. Further, the \$20,000 limit could be binding on middle-income taxpayers who had mortgage interest on a second home held for personal use.

While not binding on most taxpayers, the Rostenkowski formula is conceptually quite different from the Reagan approach and should be viewed as an assault on the traditional sanctity of principal residence mortgage interest deductibility. The reason is that a taxpayer with principal mortgage interest of less than \$20,000 but total interest deductions in excess of \$20,000 would find that any additional principal residence mortgage interest would not be deductible. For example, a taxpayer who purchased a \$175,000 home with a 20 percent downpayment and a \$140,000 mortgage at 13 percent would have first-year interest of about \$18,000. Such a taxpayer is likely to have about \$2,500 of non-mortgage interest deductions. The total of \$20,500 of interest deductions would exceed the \$20,000 limit and so \$500 of interest would be nondeductible. Under these circumstances an additional dollar of mortgage interest, due either to higher interest rates or a larger mortgage amount, would not increase the total amount of allowable interest deductions.

The Reagan proposal would repeal deductibility of all state and local taxes including income taxes, real property taxes, sales taxes, and personal property taxes. This clearly would raise the after-tax cost of owner-occupied homes as well as tend to raise the tax liability of taxpayers who itemize. Under the Rostenkowski proposal deductibility of state and local sales and personal property taxes would also be repealed. However, state and local income and real property taxes would be deductible up to the greater of (1) \$1,000 or (2) the amount of such taxes in excess of 5 percent of adjusted gross income (AGI). While this formula does provide some deductibility of these taxes, it should be noted that state and local income taxes would absorb virtually all of the allowed deductibility. For example, as shown in Table 2 the average state and local income tax deduction for an itemizing taxpayer with an AGI of \$36,000 would be about \$1,300. If this taxpayer owned an \$85,000 home (a \$36,000 income would be the minimum income required to purchase an \$85,000 home with a 20 percent downpayment at current interest rates) the real property tax deduction would be about \$1,200. The maximum deduction this taxpayer could take is \$1,000 as the amount of deductible taxes in excess of five percent of AGI is about \$700. This \$1,000 of deductibility is totally accounted for by the state and local income tax which this taxpayer would have paid even if he were a renter. As a result, the effective real property tax deduction is zero.

The Reagan and Rostenkowski proposals would make several other important changes to current law. Both would repeal the current 10 percent two-earner deduction and income averaging. Miscellaneous deductions would be limited to the amount in excess of one percent of AGI, while the Reagan proposal would allow this deduction for non-itemizers as well as itemizers. Deductions for charitable contributions by non-itemizers would be repealed. Both proposals would further expand the tax base by including in gross income a small amount of employer paid fringe benefits, although the approaches taken are significantly different. For health insurance, the Reagan proposal would tax the first \$120 per year of employer-paid premiums for individual coverage and the first \$300 per year for family coverage. In contrast, the Rostenkowski proposal would tax premiums above \$120 per month for individual coverage and \$300 per month for family coverage. Further, the Rostenkowski proposal would tax all employer-paid life insurance premiums while the Reagan proposal would retain current law where premiums for insurance over \$50,000 are taxed.

Table 2

Analysis of State and Local Income and
Real Property Tax Deductibility
Under the Rostenkowski Proposal

AGI	\$21,500	\$36,000	\$ 64,000
Home Value	<u>\$50,000</u>	<u>\$85,000</u>	<u>\$150,000</u>
State and Local Income Tax ^{1/}	\$ 700	\$ 1,300	\$ 2,600
Real Property Tax ^{2/}	\$ 715	\$ 1,216	\$ 2,145
<u>Total</u>	\$ 1,415	\$ 2,516	\$ 4,745
5% of AGI	\$ 1,075	\$ 1,800	\$ 3,200
Excess	\$ 340	\$ 716	\$ 1,545
Maximum Deduction	\$ 1,000	\$1,000	\$ 1,545
Effective Property Tax Deduction	\$ 300	0	0

^{1/}SOURCE: 1983 Statistics of Income—Individual Income Tax Returns.

^{2/}According to the U.S. Advisory Commission on Intergovernmental Relations the weighted-average effective property tax rate for single-family homes is 1.43 percent.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Specific to owner-occupied housing, both proposals would retain the current rollover of capital gains on the sale of a principal residence and the \$125,000 one-time exclusion of gain on the sale of a principal residence by taxpayers 55 or older. However, the Reagan proposal would repeal the tax exempt status of mortgage revenue bonds (MRBs). Under the Rostenkowski proposal MRBs would remain tax-exempt but would be targeted more toward lower income individuals while more restrictive volume limitations would be imposed.^{1/ 2/}

Table 3 presents estimated impacts of both the Reagan and Rostenkowski proposals on the after-tax cost and the market value of owner-occupied homes. Estimates are provided for three home prices--\$50,000, \$85,000 and \$150,000. All tax calculations are based on the minimum income required to purchase such a home assuming current interest rates and industry-wide lending criteria. Due to the loss of property tax deductibility under both proposals, and the reduced value of the mortgage interest deduction resulting from the lower marginal tax rates and the increased ZBA, the after-tax cost of ownership of principal residences would rise significantly under both proposals. The annual after-tax cost of an \$85,000 home would rise by \$1,241 or 16 percent under the Reagan proposal and by \$1,525 or 20 percent under the Rostenkowski proposal. The larger increase under the Rostenkowski proposal is primarily due to the \$3,000 larger ZBA under that proposal. The percentage increase in the annual after-tax cost of the \$50,000 home would be less under both proposals since the decline in marginal tax rates at that income level would be relatively smaller. (See Appendices A, B, and C for greater detail).

The rise in the after-tax cost of owner-occupied homes would diminish their affordability to potential buyers and therefore make them worth less in the marketplace. Under the Reagan proposal the value of an \$85,000 home is likely to fall by 14 percent or about \$12,000 while under the Rostenkowski proposal the decline in value is likely to be 17 percent or nearly \$15,000. The percentage decline in value would be somewhat less for lower priced homes since the percentage increase in after-tax cost would be somewhat less. The decline in home values will vary from state to state as property tax rates vary significantly.^{3/} (See Appendix D for state detail).

It is important to note that, contrary to what some advocates of tax reform have asserted, a decline of home values due to these proposed changes in tax law would not benefit first-time buyers or current homeowners who would like to upgrade their housing. For example, under current law the annual after-tax cost of an \$85,000 home is about \$7,760 or about \$650 per month. Under the Reagan proposal that after-tax cost would rise to about \$9,000 or \$750 per month. This increase in after-tax cost is likely to prompt a decline in value such that the after-tax cost under the new tax system would be roughly equal to what it is under current law. Thus, the 14 percent decline in value to about \$73,000 would cause the after-tax cost to fall back to \$650 per month. The point is that regardless of whether the home costs \$85,000 under current law or \$73,000 under the Reagan proposal, it is still going to cost the homebuyer \$650 per month after-tax to own the home.

Table 3

Comparison of After-Tax Homeownership Costs Under Current Law,
the Reagan Proposal, and the Rostenkowski Proposal^{1/}
(Mortgage Rates Unchanged)

EXAMPLE #1	Cost of Home - \$50,000		
	Required Income - \$21,500		
	<u>1986</u>	<u>Reagan</u>	<u>Rostenkowski</u>
	<u>Current Law</u>	<u>Proposal</u>	<u>Proposal</u>
Before Tax Cost (\$)	\$5,915	\$5,915	\$5,915
Marginal Tax Rate (%)	16%	15%	15%
Tax Savings (\$)	868	470	189
After Tax Cost (\$)	5,047	5,445	5,726
Change in Cost (\$)	—	+398	+679
Change in Cost (%)	—	+8%	+13%
Change in Home Value (%)	—	-8%	-13%
EXAMPLE #2	Cost of Home - \$85,000		
	Required Income - \$36,000		
	<u>1986</u>	<u>Reagan</u>	<u>Rostenkowski</u>
	<u>Current Law</u>	<u>Proposal</u>	<u>Proposal</u>
Before Tax Cost (\$)	\$10,056	\$10,056	\$10,056
Marginal Tax Rate (%)	25%	15%	15%
Tax Savings (\$)	2,298	1,057	773
After Tax Cost (\$)	7,758	8,999	9,283
Change in Cost (\$)	—	+1,241	+1,525
Change in Cost (%)	—	+16%	+20%
Change in Home Value (%)	—	-14%	-17%
EXAMPLE #3	Cost of Home - \$150,000		
	Required Income - \$ 64,000		
	<u>1986</u>	<u>Reagan</u>	<u>Rostenkowski</u>
	<u>Current Law</u>	<u>Proposal</u>	<u>Proposal</u>
Before Tax Cost (\$)	\$17,745	\$17,745	\$17,745
Marginal Tax Rate (%)	38%	25%	25%
Tax Savings (\$)	5,908	3,900	3,588
After Tax Cost (\$)	11,837	13,845	14,157
Change in Cost (\$)	—	+2,008	+2,320
Change in Cost (%)	—	+17%	+20%
Change in Home Value (%)	—	-15%	-17%

^{1/}All examples assume a 20 percent downpayment, a 30 year fixed rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Required income assumes 25 percent of income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions.

It is also important to put this potential decline in home values in perspective. Statistics compiled by the Federal Reserve Board indicate that the total stock of owner-occupied homes in this country has a value of roughly \$3.5 trillion.^{4/} An average decline of value of between 14 and 17 percent would represent an aggregate loss of wealth of between \$500 billion and \$600 billion. The bulk of the net worth of the typical family is the equity they have in their home. Since the average amount of homeowner's equity represents about 70 percent of the home value, the decline in home values would destroy 20 percent to 25 percent of the typical families life savings.

There has been some confusion over the potential decline in home values due to tax revision as many people are under the impression that even though the after-tax cost of owning a home would rise, the homeowner's overall federal tax burden would fall. Thus, the argument is frequently made that with more of their gross income at their disposal homebuyers could afford to pay the increased costs of homeownership and home values would be maintained. Analysis reveals, however, that the federal tax burden on homeowners is more likely to rise under both the Reagan proposal and the Rostenkowski proposal than it is to fall. This result is due to the fact that homeowners, particularly recent homeowners, tend to itemize deductions and the loss in both the amount of deductions and their value overwhelms the impact of lower tax rates and the higher personal exemption.

Table 4 presents comparisons of the federal tax liability of a one-earner family of four and a two-earner family of four under current law, the Reagan proposal, and the Rostenkowski proposal. Comparisons are between recent homeowners and renters at income levels of \$21,500, \$36,000, and \$64,000 which correspond to the income levels and home values used in Table 3. In nearly all cases the homeowner's tax burden rises, particularly in the case of two-earner families who would lose the two-earner deduction, while the tax burden of renters at the same income level would decline. For example, at the \$36,000 income level which corresponds to the average sales price of \$85,000, a recent homeowner's tax burden would rise by \$67 or 2.7 percent under the Reagan proposal for the one-earner case and by \$174 or 8.2 percent for the two-earner case. For a renter at the same income level and the same amount of non-housing itemized deductions, tax burden under the Reagan proposal would decline by \$1,174 or 24.4 percent of the one-earner case and decline by \$1,025 or 23.5 percent for the two-earner case. Under the Rostenkowski proposal the increase in the homeowners tax burden and the decline in the renters tax burden tend to be even greater due primarily to the larger increase in ZBA. (See Appendix E for greater detail).

To further support the conclusion that the Reagan and Rostenkowski proposals are likely to depress home values, Table 5 combines the increase in after-tax homeownership costs with the decline in disposable income or increased tax liability of the typical recent homebuyer to see what impact these proposals would have on after-tax homeownership costs as a percent of disposable income. Under current law the after-tax cost of an \$85,000 home would absorb about 23 percent of the disposable income of a recent homebuyer with a gross income of \$36,000. If home values were to remain unchanged, that percentage would have to rise to about 27 percent of disposable income under the Reagan proposal and about 28 percent under the Rostenkowski proposal. It is unlikely that homebuyers would be willing to devote an additional 4 to 5 percent of their after-tax income for the same quantity of housing services. Further, given the current concern over foreclosures, it is unlikely that mortgage lenders and insurers would be willing to relax their underwriting criteria to allow consumers to devote those additional amounts of their disposable income to housing costs.

Table 4

Impact of the Reagan and Rostenkowski Proposals
on the Federal Tax Liabilities of Homeowners and Renters
with Equal Incomes^{1/}

	Family Income					
	\$21,500		\$36,000		\$64,000	
	Homeowner	Renter	Homeowner	Renter	Homeowner	Renter
<u>One-Earner</u>						
<u>Family of Four^{2/}</u>						
Current Law	\$ 997	\$1,865	\$ 2,505	\$4,803	\$ 6,783	\$12,691
Reagan Proposal	981	1,451	2,572	3,629	6,629	10,529
Change from \$	-16	-414	+67	-1,174	-154	-2,162
Current Law: %	-1.6%	-22.2%	+2.7%	-24.4%	-2.3%	-17.0%
Rostenkowski Proposal	1,086	1,275	2,677	3,450	6,432	10,020
Change from \$	+89	-590	+172	-1,353	-351	-2,671
Current Law: %	+8.9%	-31.6%	+6.9%	-28.2%	-5.2%	-21.0%
<u>Two-Earner</u>						
<u>Family of Four^{3/}</u>						
Current Law	\$ 662	\$1,522	\$ 2,113	\$4,369	\$ 5,969	\$11,952
Reagan Proposal	695	1,165	2,287	3,344	6,308	10,208
Change from \$	+33	-357	+174	-1,025	+339	-1,744
Current Law: %	+5.0%	-23.5%	+8.2%	-23.5%	+5.7%	-14.6%
Rostenkowski Proposal	800	989	2,392	3,165	6,111	9,699
Change from \$	+138	-533	+279	-1,204	+142	-2,253
Current Law: %	+20.8%	-35.0%	+13.2%	-27.6%	+2.4%	-18.9%

^{1/} Mortgage interest and property tax deductions for families with incomes of \$21,500, \$36,000, and \$64,000 are based on homes costing \$50,000, \$85,000 and \$150,000, respectively. The mortgage interest deduction is the first year interest on an 80 percent loan-to-value ratio loan with an interest rate of 13 percent. The property tax deduction is 1.43 percent of property value. All non-deductions, according to the 1983 Statistics of Income--Individual Income Tax Returns. Renters are assumed to have the same level of these deductions as homebuyers.

^{2/} Child-care credit not used.

^{3/} Income of family is split two-thirds, one-third between the two earners. Two-earner deduction and child-care credit are used.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®

Table 5

After-tax Homeownership Costs of an \$85,000 Home as a Percent
of Disposable Income Under Current Law,
the Reagan Proposal and the Rostenkowski Proposal

	Current Law	Reagan Proposal	Rostenkowski Proposal
AGI	\$36,000	\$36,000	\$36,000
Tax Liability ¹	2,505	2,572	2,677
Disposable Income	33,495	33,428	33,323
After-tax cost of Homeownership ²	7,758	8,999	9,283
Percent of Disposable Income	23.2%	26.9%	27.9%
Change from Current Law (percentage points)	—	3.7%	4.7%
(percent)	—	16%	20%

¹/Based on the one-earner case.

²/Based on an \$85,000 home purchased with a 20 percent downpayment and a 30-year, fixed-rate mortgage at 13 percent, and property taxes equal to 1.43 percent of the property value.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

MRB Financed Homes

Over the past four years over 500,000 lower-priced homes have been purchased with the aid of tax-exempt mortgage revenue bonds (MRBs). Since the income yielded to investors in these bonds is exempt from federal taxation, investors are willing to accept yields significantly below the yields provided by comparable assets which generate taxable income. This allows mortgage funds to be lent to low- and moderate-income homebuyers at about 2 1/2 percentage points below the going market rate.

The repeal of the tax-exempt status of MRBs under the Reagan proposal and the more restrictive volume limitations under the Rostenkowski proposal represent a special case in terms of impact on after-tax homeownership costs. Potential homebuyers who otherwise would have relied on MRB financing would confront not only the increase in after-tax cost due to lower marginal tax rates, the increase in the ZBA, and the total or partial loss of property tax deductibility but also the increase in after-tax cost due to the loss of the below-market interest rate. Table 6 presents an example of a \$50,000 home with MRB financing at 2 1/2 percentage points below the market rate. Under current law the annual after-tax cost would be roughly \$4,200. Under the Reagan proposal the after-tax cost would rise by about \$1,250 or 30 percent while under the Rostenkowski proposal the after-tax cost would rise by about \$1,540 or 37 percent.

Table 6

Impact of the Loss of MRB Financing and the Reagan and Rostenkowski Proposals
on the After-Tax Cost of a \$50,000 Home^{1/}

	Current <u>Law</u>	Reagan <u>Proposal</u>	Rostenkowski <u>Proposal</u>
Before-Tax Cost	\$4,915	\$5,915	\$5,915
Mortgage Interest	5,200	5,200	5,200
MRB Savings	-1,000	--	--
Property Taxes	715	715	715
Marginal Tax Rate	16%	15%	15%
Tax Savings	728	470	189
Mortgage Interest	770	470	179
MRB Savings	-148	--	--
Property Tax	106	--	10
After-Tax Cost	4,187	5,445	5,726
Change: \$	--	1,258	1,539
%	--	30%	37%

^{1/}Example assumes a joint tax return with AGI of \$21,500 and with four exemptions. Home is financed with a 20 percent downpayment and a fixed-rate, 30-year mortgage for the remaining 80 percent of the purchase price. MRB financing is at 10.5% while conventional financing is at 13%. Property taxes are 1.43 percent of the home value.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Second Homes Held for Personal Use

Second homes held for personal use represent another special case since, in addition to losing property tax deductibility, it is likely that some or all interest deductibility would also be lost due to the limitations on deductibility of personal interest other than mortgage interest on a principal residence included in both the Reagan and Rostenkowski proposals. It is important to note that we are concerned here only with second homes held for personal use. Second homes which are held as rental properties fall under the tax rules of property used in a trade or business.

Table 7 presents an example of the potential increase in after-tax cost of a typical second home under both the Reagan and Rostenkowski proposals.^{5/} It is safe to conclude that property taxes would not be deductible under the Rostenkowski proposal since as shown in Table 2, allowed deductions would likely be completely used up by state and local income taxes even for those taxpayers who found it advantageous to elect the excess over 5 percent of AGI option. It is less certain as to the amount of second home mortgage interest that would be deductible since that will depend upon the individual circumstances of each taxpayer. For that reason, Table 7 presents a range of potential impacts on after-tax cost from Case I, where all mortgage interest is deductible, to Case III where none is deductible. The example suggests that even in the best of circumstances the after-tax cost is likely to increase by 26 percent. To the extent that mortgage interest is not deductible the increase in after-tax cost increases. In the worst possible case, where none of the second home mortgage interest is deductible, the after-tax cost rises by 61 percent and equals the before-tax cost.

Table 7

Impact of the Reagan Proposal and the Rostenkowski Proposal
on a Typical \$60,000 Second Home^{1/}

	1986 Current Law	Tax Revision		
		Case I	Case II	Case III
Before-Tax Cost	\$7,098	\$7,098	\$7,098	\$7,098
Mortgage Interest	6,240	6,240	6,240	6,240
Property Tax	858	858	858	858
Marginal Tax Rate	38%	25%	25%	25%
Tax Savings	2,697	1,560	780	0
Mortgage Interest	2,371	1,560	780	0
Property Tax	326	--	--	--
After-Tax Cost	4,401	5,538	6,318	7,098
Change in Cost (%)		+26%	+44%	+61%
Change in Cost (\$)		+1,137	+1,917	+2,697
Change in Value (%)		-22%	-28%	-38%

Case I: All mortgage interest is deductible since dividend and interest income raises the limit on interest deductions so that it is not binding on the taxpayer.

Case II: Only half (\$3,120) of mortgage interest is deductible due to the limit on personal interest deductions.

Case III: No mortgage interest is deductible due to the limit on personal interest deductions.

^{1/} This table assumes a \$60,000 second home purchased with a \$12,000 downpayment and a \$48,000 mortgage at 13 percent resulting in about \$6,240 of mortgage interest the first year. Property taxes are assumed to be 1.43 percent of the property value or \$858. The buyer is assumed to have a \$70,000 adjusted gross income, to file a joint return with 4 exemptions.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Commercial and Rental Residential Real Estate

Table 8 presents a side-by-side comparison of the main provisions of current tax law which affect the yields on investments in commercial and rental residential real estate with their status under both the Reagan and Rostenkowski proposals. While all of the proposed changes are important to some real estate investments and investors, there is a core of proposed changes which would impact virtually all real estate investments.

A) Maximum Marginal Tax Rate

Both the Reagan and Rostenkowski proposals would reduce the maximum marginal personal tax rate from 50 percent to 35 percent.

B) Depreciation

Under current law real property can be depreciated over 19 years using either the straight-line method or 175 percent declining balance method. Under the Rostenkowski proposal real property would be depreciated over 30 years using the straight-line method. The Reagan proposal would introduce inflation indexing with depreciation deductions equaling 4 percent of the inflation adjusted basis. As documented in Appendix F, depreciation deductions under both the Reagan and Rostenkowski proposals would be considerably less than under present law. For example, for the typical ten year holding period the present value of depreciation deductions under the Reagan proposal would be 35 percent less than current law while under the Rostenkowski proposal the present value of depreciation deductions would be 51 percent less than current law.

C) Capital Gains

Under current law 60 percent of the gain on capital assets is excluded from tax, with the remaining 40 percent taxed as ordinary income. (However, excluded gain is a tax preference item in the computation of the individual minimum tax). With a maximum marginal personal tax rate of 50 percent, the maximum capital gains tax rate is 20 percent which is 60 percent lower than the rate on ordinary income.

Under the Rostenkowski proposal the capital gains exclusion would be reduced to 40 percent. With a maximum marginal personal rate of 35 percent, the maximum capital gains tax rate would rise to 21 percent which is just 40 percent lower than the maximum rate on ordinary income.

Table 8

Comparison of Tax Provisions Impacting Commercial Real Estate Under
Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	1986 Current Law	Reagan Proposal	Rostenkowski Proposal
Personal Marginal Tax Rates	14 rate brackets from 11% to 50%	3 rate brackets, 15%, 25%, 35%	3 rate brackets, 15%, 25%, 35%
Personal Deductions			
Interest	Unlimited deductibility except for interest incurred to carry investment property which is limited to \$10,000 plus net investment income. Limited partner's share the interest expense of the partnership <u>not</u> subject to limit.	Unlimited deductibility of mortgage interest on principal residence. All other interest limited to \$5,000 plus net investment income, including limited partner's share of the interest expense of the partnership.	All personal interest deductions, including the limited partner's share of the interest expense of the partnership, are limited to the <u>greater</u> of 1) interest on debt secured by principal residence, or 2) \$20,000, plus net investment income.
Corporate Tax Rates	15% to 40% on first \$100,000, 46% over \$100,000. Flat rate of 46% at \$1,405,000 or higher.	15% to 25% on first \$75,000, 33% over \$75,000. Flat rate of 33% at \$345,000 or higher.	15% to 30% on first \$75,000, 35% over \$75,000. Flat rate of 35% at \$350,000 or higher.
Depreciation			
General	19 years, 175% declining balance.	4% of inflation adjusted basis, 28 year closeout.	30 years, straight line.
Low-Income Rental Housing	15 years, 200% declining balance.	4% of inflation adjusted basis, 28 year closeout.	18 years, 150% declining balance.

Table 8 (cont'd)

Comparison of Tax Provisions Impacting Commercial Real Estate Under
Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	<u>1986 Current Law</u>	<u>Reagan Proposal</u>	<u>Rostenkowski Proposal</u>
Depreciation subject to recapture as ordinary income			
Residential	Gain is recap- tured only to the extent that ac- celerated deprec- iation deductions exceeds straight line deductions (Section 1250 recapture).	All gain on the disposition of de- preciable property taxed as ordinary income.	All depreciation, to the extent of gain, recaptured as ordinary income.
Low-Income	Section 1250 re- capture plus re- phase out of re- capture at the rate of 1% a month after the property has been held for 100 months.	All gain on the disposition of de- preciable property taxed as ordinary income.	All depreciation, to the extent of gain, recaptured as ordinary income.
Non-Residential	No recapture if depreciated using straight line method. If ac- celerated de- preciation is used, all de- preciation, to the extent of gain, is recap- tured (Section 1245 recapture).	All gain on the disposition of de- preciable property taxed as ordinary income.	All depreciation, to the extent of gain, recaptured as ordinary income.
Capital Gains			
		<u>Depre/ ciable Assets</u>	<u>Nondepre/ ciable Assets</u>
Exclusion	60%	0	50%
Basis indexed for inflation	No	Yes	No

Table 8 (cont'd)

Comparison of Tax Provisions Impacting Commercial Real Estate Under
Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	<u>1986 Current Law</u>	<u>Reagan Proposal</u>	<u>Rostenkowski Proposal</u>
Construction Period Interest and Taxes	10 year amort- ization allowed.	Repealed. Added to real property basis.	Repealed. Added to real property basis.
Interest Expense	Fully deductible for property used in trade or business.	Same as current law. (Except for limited partners).	Same as current law. (Except for limited partners).
Investment Tax Credit	6%-10%	Repealed	Repealed
Rehabilitation Tax Credits	15% credit, with with full basis adjustment, for non-residential structures at least 30 years old.	Repealed	10% credit for buildings con- structed before 1935.
	20% credit, with full basis ad- justment, for nonresidential structures at least 40 years old.	Repealed	10% credit for buildings con- structed before 1935.
	25% credit, with 50% basis ad- justment, for certified historic resi- dential and non- residential structures.	Repealed	20% credit with full basis ad- justment.
Section 167K Rules	Rehabilitation expenses for low- income housing can be amortized over 60 months.	Repealed	Retain current law with minor modifications.
Installment Sales	Taxation defer- red until pay- ments received.	No deferral if receivables pledged as collateral.	No deferral if receivables pledged as collateral.

Table 8 (cont'd)

Comparison of Tax Provisions Impacting Commercial Real Estate Under Current Law, the Reagan Proposal, and the Rostenkowski Proposal

	<u>1986 Current Law</u>	<u>Reagan Proposal</u>	<u>Rostenkowski Proposal</u>
"At-Risk" Rules	Real estate exempt. Cumulative losses may exceed the amount of equity plus recourse financing.	"At-Risk" rule extended to real estate. Cumulative losses limited to equity plus recourse financing.	"At-Risk" rule extended to real estate. Cumulative losses limited to equity plus recourse financing.
Industrial Development Bonds			
Multi-family Rental Housing	Tax exempt.	No tax exemption.	Tax-exempt, with greater targeting toward lower income individuals and with volume limitations.
Other	Tax-exempt, volume restrictions.	No tax exemption.	Tax exempt, but fewer uses qualify for exemption and more restrictive volume limitations.
Individual Alternative Minimum Tax			
Rate	20%	20%	25%
Exemption Amount	\$40,000 for joint returns.	Sum of the following: 1) \$15,000 for joint returns, 2) the first \$10,000 of preferences, 3) the taxpayer's personal exemptions.	\$40,000 for joint returns.
Real Estate Preferences			
Accelerated Depreciation on Real Property.	Excess of 19 years, 175% declining balance over 19 years straight-line.	For property placed in service beginning in 1986, excess of 4% of inflation adjusted basis, 28 year closeout, over 3% of inflation adjusted basis, 63 year closeout.	For property placed in service beginning in 1986, excess of 30 year straight-line over 40 year straight-line.
Net Capital Gain Deduction	Yes	Yes	Yes

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Commercial and Rental Residential Real Estate (cont'd)

Under the Reagan proposal a major distinction would be made between depreciable assets such as structures and nondepreciable assets such as land, stocks, and bonds. For nondepreciable assets a 50 percent exclusion would be retained while the asset basis would not be indexed for inflation. With a maximum marginal personal rate of 35 percent, the maximum capital gains tax rate would be 17 1/2 percent which would be 50 percent less than the maximum rate on ordinary income. For depreciable assets, there would be no exclusion. However, the amount of gain would be based on the inflation-indexed adjusted basis. Analysis indicates that if the asset appreciates at less than 3 1/2 percentage points above the overall inflation rate, the effective capital gains tax rate would be less than the 17 1/2 percent rate achieved with the 50 percent exclusion. However, if the property appreciates at more than 3 1/2 percentage points above the overall inflation rate, the effective capital gains tax rate is higher than that on nondepreciable assets. Consequently, above average real estate investments would be taxed at a rate greater than financial assets that appreciated at a similar rate.

Table 9

Comparison of Indexing versus 50% Exclusion Capital Gains Treatment^{1/}

Overall Inflation Rate	Property Appreciation Rate	Tax	
		Indexing	Exclusion
5%	0%	-22,011	0
5%	5%	0	11,006
5%	8.5%	22,100	22,100
5%	10%	33,770	27,890
5%	15%	84,583	53,297

^{1/}Example based on a \$100,000 property held for 10 years by a taxpayer in the 35% bracket. For simplicity the effects of depreciation, property taxes, selling expenses and the alternative minimum tax, if any, are ignored.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

D) Depreciation Recapture

Under current law commercial real estate is subjected to Section 1245 recapture where if the structure is depreciated using the straight-line method no depreciation is subject to recapture as ordinary income. On the other hand, if the 175 percent declining balance method is used, all depreciation, to the extent of gain, is recaptured as ordinary income. Due to the more onerous recapture provision when accelerated depreciation is used, most commercial structures are depreciated using the straight-line method. Rental residential real estate is subject to Section 1250 recapture, where only depreciation in excess of straight-line is recaptured as ordinary income.

Commercial and Rental Residential Real Estate (cont'd)

Under both the Reagan and Rostenkowski proposals, all depreciation, to the extent of gain, would be recaptured as ordinary income. However, ~~there is a~~ major distinction between the two since under the Reagan proposal gain would be based on an inflation-indexed adjusted basis whereas under Rostenkowski the adjusted basis would not be indexed.

E) At-Risk

Under current law real estate investments are exempt from the at-risk rule which limits the cumulative losses generated by an investment to the amount the investor is at risk, which has been defined as equity plus recourse financing or financing for which the investor has pledged collateral other than the asset in question. Mortgages tend to be nonrecourse loans meaning that the mortgaged property is the sole security for the loan. Real estate has been exempt from the at-risk rule because mortgage lenders have been willing to make nonrecourse loans. However, both the Reagan and Rostenkowski proposals would extend the at-risk rule to real estate.

F) Investment Interest Limitation

Under current law limited partners in a limited partnership have been generally regarded to be engaged in a trade or business so that their share of the interest expense of the partnership has not been subject to the existing limitation on personal deductions of investment interest. Both the Reagan and Rostenkowski proposals would include the limited partner's share of the interest expense of a partnership as investment interest deductions of which would be limited. For the most part, a limited partner's interest deductions would be limited to his share of the net investment income of the partnership, defined as net operating income less depreciation.

Table 10 presents the impacts of these six core proposals on yields provided by commercial and rental residential real estate investments. Impacts are presented for typical investments with 10 percent equity (90 percent loan-to-value ratio) and with 25 percent equity (75 percent loan-to-value ratio). Impacts are also differentiated between commercial real estate, where under current law the straight-line method tends to be used to depreciate real property, and for rental residential real estate, where the 175 percent declining balance (ACRS) method tends to be used. For this reason, the relative decline in yields tends to be greater for residential than for commercial. Several tendencies are evident. First, in all cases the Rostenkowski proposal results in a larger decline in yield than the Reagan proposal. Second, the relative decline in yield increases as the loan-to-value ratio increases. Finally, due to the interest deduction limitation, limited partners would experience a sharper decline in yield than would general partners or sole proprietors.

Declines in yields of this magnitude would undoubtedly cause a severe decline in investment in new commercial and rental residential real estate along with a significant decline in the value of existing structures. Over time the reduced rate of new investment will cause both commercial and residential rents to rise more rapidly than would otherwise be the case.

Table 10

Impact of the Reagan and Rostenkowski
Proposals on Yields Provided by Commercial
and Rental Residential Real Estate Investments

	Relative Decline in Yield ^{1/}			
	10% Equity		25% Equity	
	Reagan ^{2/} Proposal	Rostenkowski Proposal	Reagan ^{2/} Proposal	Rostenkowski Proposal
<u>Commercial^{3/}</u>				
General Partner or Sole Proprietor ^{4/}	-28.4%	-32.5%	-6.5%	-15.6%
Limited Partner ^{5/}	-40.8%	-37.7%	-16.1%	-19.9%
<u>Residential^{3/}</u>				
General Partner or Sole Proprietor ^{4/}	-40.1%	-43.6%	-14.7%	-23.0%
Limited Partner ^{5/}	-50.4%	-47.8%	-23.5%	-27.0%

^{1/}Yield is measured by 10-year after-tax internal rate of return (IRR), which is the discount rate at which the present value of all future after-tax benefits equals the initial equity investment.

^{2/}For purposes of indexing of capital assets and adjusted basis for inflation a rate of 5 percent is assumed.

^{3/}Assumptions underlying typical commercial and residential real estate investments:

Basis: \$1,000,000 project acquired 1/1/86 with original basis allocated \$150,000 to land, \$50,000 to furniture, fixtures and equipment, and \$800,000 to real property.

Current Law Real Property Depreciation: Commercial-19 years S.L.
Residential-19 years ACRS

Financing: A 30-year conventional mortgage at 13 % interest, evaluated at both 10% and 25% cash down.

Income and Expenses: Net operating income of \$100,000 increasing at 5% per year.

Projected Value: Starting Value of \$1,000,000 increasing at 5% per year.

Expenses of Sale: Selling expenses of 6% upon ultimate sale.

Ownership: Individual taxpayer(s) in a marginal tax bracket of 50% under current law.

^{4/} Impact on general partner or sole proprietor reflects reduction in the maximum marginal personal tax rate to 35 percent, changes in depreciation, capital gains, depreciation subject to recapture, and extension of the at-risk rule to real estate. Impact on limited partner adds to all of the above the limit on investment interest deductions. Interest deductions of the investment are limited to the net investment income of the investment, which is defined as net operating income less depreciation actually taken. Interest not deducted in any year is carried forward indefinitely.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

Revenue Impacts

Table 11 presents estimates of the impact on federal revenues of several of the changes in tax law proposed in both the Reagan and Rostenkowski proposals. The estimates provide an interesting comparison between revenues to be gained or lost through various provisions both with a proposal and between proposals. For example, the total repeal of state and local tax deductibility under the Reagan proposal raises \$148.9 billion over five years, nearly 62 percent of the revenues lost through personal rate reductions. In contrast, the Rostenkowski proposal relies much less on limiting state and local tax deductions to finance personal rate cuts. However, both proposals significantly shift the tax burden away from individuals and onto business. This is dubious policy for an economy already short on investment and struggling to compete in international markets.

Table 11

Selected Impacts of Tax Reform Proposals on Federal Revenues
(1986 to 1990, Billions of Dollars)

	Reagan Proposal ^{1/}	Rostenkowski Proposal ^{2/}
Individual Rate Reductions (including capital gains)	-\$242.1	-\$225.8
Corporate Rate Reductions (including capital gains)	-\$153.4	-\$99.0
Changes in deductibility of state and local taxes	\$148.9	\$64.9
Changes in depreciation schedules (equipment and structures)	\$37.1	\$50.7
Repeal Investment Tax Credit	\$165.4	\$114.2
Changes in tax treatment of Mortgage Revenue and Industrial Development Bonds	\$13.0	\$5.9
Changes in rehabilitation tax credits	\$6.5	\$2.6
Limitations on personal deductions of interest other than principal home mortgage interest	\$3.1	\$0.5
Extend at-risk rule to real estate	\$0.2	\$0.2
Changes in minimum tax	\$4.2	\$36.0
Individual	\$1.3	\$22.2
Corporate	\$2.9	\$13.8
Net Change in Receipts	\$13.4	-\$4.0
Individual	-\$131.8	-\$164.3
Corporate	\$118.4	\$160.3

^{1/}Source: The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity, May 1985, Appendix C, pp. 453-461.

^{2/}Source: Joint Committee on Taxation, September 30, 1985, JCX-24-85.

Footnotes

^{1/}Under current law, 90% of MRB proceeds must be used by first-time homebuyers while all homes purchased with MRB financing must cost no more than 110% of the average area purchase price (120% in targeted areas). Under the Rostenkowski proposal, 100% of MRB proceeds must be used by first-time homebuyers, all homes purchased with MRB financing must cost no more than 90% of the average area purchase price (110% in targeted areas), at least 50% of MRB proceeds must go to borrowers whose family income does not exceed 90% of the area median income while all proceeds must go to families with incomes less than 115% of median income, in targeted areas up to 1/3 of MRB proceeds may go to families with incomes below 140% of either the targeted area median income or the state median income, whichever is more, and Mortgage Credit Certificates (MCCs) would be subject to the same targeting requirements as MRBs.

^{2/}Current law annual state volume restrictions for MRBs only are the greater of (1) 9 percent of the average annual aggregate principal amount of mortgages executed during the preceding 3 years for single-family owner-occupied residences in the state, or (2) \$200 million. Under the Rostenkowski proposal MRBs, IDBs and student loan bonds would fall under a single volume limit of \$150 per resident of the state, falling to \$100 per resident after 1987 to reflect the present-law sunset of tax-exempt MRB authority.

^{3/}The potential change in home values due to the Reagan and Rostenkowski proposals are computed as follows:

(a) First year mortgage interest equals the home value (V) times the loan-to-value ratio (LV) times the mortgage interest rate (r). In all calculations LV = .80 and r = .13.

(b) Property taxes are equal to V times the property tax rate (p) which is equal to .0143.

(c) Total before-tax cost (BTC) of mortgage interest and property taxes equals:

$$BTC = V(LV)(r) + V(p) = V(LV*r + p)$$

(d) Homeownership tax savings (TS) is approximated by the marginal tax rate (t) times all deductible homeownership expenses less the amount by which the ZBA exceeds non-homeownership itemized deductions or the excess ZBA (EZBA). If the non-housing itemized deductions are equal to or greater than the ZBA then EZBA = 0. Under current law,

$$TS = t(BTC - EZBA).$$

Under the Reagan proposal, where property tax deductibility is specifically repealed,

$$TS = t[V(LV)(r) - EZBA].$$

Footnotes (cont'd)

Under the Rostenkowski proposal, where some property tax deductibility may occur depending upon the typical homeowner's circumstances,

$$TS = t[V(LV)(r) + AP - EZBA],$$

where AP equals allowed property tax deductions. Note that TS closely approximates but does not exactly equal actual tax savings due to the progressive marginal tax rate structure. Actual tax savings may be somewhat less since the last dollar of homeownership deductions is likely to be evaluated at a higher marginal tax rate than the first dollar of such deductions.

(e) After-tax cost (ATC) equals:

$$ATC = BTC - TS.$$

(f) To compute the potential change in home value it is assumed that ATC remains constant across all tax regimes. Therefore, after computing ATC under current law, ATC is held constant, new values are used for t and then the expression is solved for V . Under the Reagan proposal the expression for V is,

$$V = \frac{ATC - t^*EZBA}{(LV^*r + p) - t(LV^*r)}$$

Under the Rostenkowski proposal the expression for V is,

$$V = \frac{ATC + t^*AP - t^*EZBA}{(LV^*r + p) - t(LV^*r)}$$

4/SOURCE: Balance Sheet for the U.S. Economy, Board of Governors of the Federal Reserve System, October 1985.

5/The 1983 Survey of Consumer Finances, sponsored by the Federal Reserve Board, indicated that the average value of vacation homes was \$58,600 in 1983. Interestingly, 60 percent of all vacation homes were owned by households with annual incomes of \$30,000 or less while over three-fourths of vacation homes were owned by households with incomes of \$50,000 or less.

Households Owning Seasonal Residences by Income: 1983^{1/}

Income Class (\$ thousands)	Households Owning Seasonal Residence (# thousands)	Percent of Total Households	Percent of Seasonal Residences	Average Value of Seasonal Residences
0 to 10	581	1.7	26.6	\$14,800
10 to 30	740	1.9	33.9	10,600
30 to 50	351	2.3	16.1	13,700
50 to 100	362	8.7	16.6	43,300
Greater than 100	149	18.9	6.8	94,900
Total	2,183	2.4	100.0	\$58,600

^{1/}The definition of seasonal residence includes mobile homes and time sharing units.

SOURCE: 1983 Survey of Consumer Finances.

Footnotes (cont'd)

- ^{6/} Under current law at least 20 percent (15 percent in targeted areas) of the rental housing units financed with IDBs must be occupied by persons whose income does not exceed 80 percent of the area median income when they first rent the unit. Under the Rostenkowski proposal, at least 30 percent (25 percent in targeted areas) of the rental housing units financed with IDBs would have to be occupied by persons whose income does not exceed 70 percent of the area median income, with at least 10 percent of all units being occupied by persons whose income does not exceed 50 percent of the area median income, determined on a continuing basis.
- ^{7/} Under current law, annual state volume limits on most non-governmental activity IDBs and student loan bonds are the greater of \$150 per resident or \$200 million. No volume limits are imposed on multifamily rental housing IDBs. Under the Rostenkowski proposal, all non-governmental activity IDBs, including those used to finance multi-family rental housing, student loan bonds, and mortgage revenue bonds would fall under a single volume limit of \$150 per resident, declining to \$100 per resident after 1987 to reflect the present law sunset of tax-exemption for MRBs. Unless overridden by a state statute, at least 50 percent of each state's volume would have to be used for multi-family rental housing, MRBs, or qualified veterans mortgage bonds. After 1987 that percentage would fall to 25 percent.

Impact of Tax Revision on an \$85,000 Owner-Occupied Home-^{1/}

	Current Law	Reagan Proposal	Change from Current Law		Rostenkowski Proposal	Change from Current Law	
			\$	%		\$	%
Before-Tax Cost	\$10,056	\$10,056	--	--	\$10,056	--	--
Mortgage Interest	8,840	8,840	--	--	8,840	--	--
Property Tax	1,216	1,216	--	--	1,216	--	--
Marginal Tax Rate	25%	15%	--	-40%	15%	--	-40%
Tax Savings ^{2/}	2,298	1,057	-1,241	-54%	773	-1,525	-66%
Mortgage Interest	2,020	1,057	-963	-48%	773	-1,247	-62%
Property Tax	278	--	-278	-100%	--	-278	-100%
After-Tax Cost	7,758	8,999	+1,241	16%	9,283	+1,525	20%
Home Value	85,000	72,926	-12,074	-14%	70,158	-14,842	-17%

^{1/}Example assumes a 20 percent downpayment, a 30-year, fixed-rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Family income assumes that 25 percent of gross income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions. Current tax law calculations are based on values for personal exemptions, standard deduction or zero bracket amount, and tax brackets projected for 1986.

^{2/}Tax savings is computed as the difference in tax liability between a homeowner and renter with the same AGI, the same number of exemptions, and the same amount of non-housing itemized deductions. Tax savings decline under the Reagan and Rostenkowski proposals due to lower marginal tax rates, effective elimination of property tax deductibility under both proposals, and increases in the zero bracket amount or standard deduction. Since the ZBA or standard deduction under both the Reagan and Rostenkowski proposals exceed the amount of non-housing deductions, itemized deductions in excess of the ZBA or standard deduction are less than the amount of mortgage interest. As a result tax savings is less than 15 percent of mortgage interest.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Impact of Tax Revision on an \$50,000 Owner-Occupied Home^{1/}

	Current Law	Reagan Proposal	Change from Current Law		Rostenkowski Proposal	Change from Current Law	
			\$	%		\$	%
Before-Tax Cost	\$5,915	\$5,915	—	—	\$5,915	—	—
Mortgage Interest	5,200	5,200	—	—	5,200	—	—
Property Tax	715	715	—	—	715	—	—
Marginal Tax Rate	16%	15%	—	-6%	15%	—	-6%
Tax Savings ^{2/}	868	470	-398	-46%	189	-679	-78%
Mortgage Interest	763	470	-293	-38%	179	-584	-77%
Property Tax	105	—	-105	-100%	10	-95	-90%
After-Tax Cost	5,047	5,445	+398	8%	5,726	+679	13%
Home Value	50,000	46,126	-3,874	-8%	43,389	-6,611	-13%

^{1/}Example assumes a 20 percent downpayment, a 30-year, fixed-rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Family income assumes that 25 percent of gross income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions. Current tax law calculations are based on values for personal exemptions, standard deduction or zero bracket amount, and tax brackets projected for 1986.

^{2/}Tax savings is computed as the difference in tax liability between a homeowner and renter with the same AGI, the same number of exemptions, and the same amount of non-housing itemized deductions. Tax savings decline under the Reagan and Rostenkowski proposals due to lower marginal tax rates, effective elimination of property tax deductibility under both proposals, and increases in the zero bracket amount or standard deduction. Since the ZBA or standard deduction under both the Reagan and Rostenkowski proposals exceed the amount of non-housing deductions, itemized deductions in excess of the ZBA or standard deduction are less than the amount of mortgage interest. As a result tax savings is less than 15 percent of mortgage interest.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Impact of Tax Revision on an \$150,000 Owner-Occupied Home^{1/}

	Current Law	Reagan Proposal	Change from Current Law		Rostenkowski Proposal	Change from Current Law	
			\$	%		\$	%
Before-Tax Cost	\$17,745	\$17,745			\$17,745		
Mortgage Interest	15,600	15,600			15,600		
Property Tax	2,145	2,145			2,145		
Marginal Tax Rate	38%	25%		-34%	25%		-34%
Tax Savings ^{2/}	5,908	3,900	-2,008	-34%	3,588	-2,320	-39%
Mortgage Interest	5,194	3,900	-1,294	-25%	3,462	-1,732	-33%
Property Tax	714		-714	-100%	126	-588	-82%
After-Tax Cost	11,837	13,845	+2,008	17%	14,157	+2,320	20%
Home Value	150,000	128,245	-21,755	-15%	124,865	-25,135	-17%

^{1/}Example assumes a 20 percent downpayment, a 30-year, fixed-rate mortgage with a 13 percent interest rate, and property taxes equal to 1.43 percent of the home value. Family income assumes that 25 percent of gross income is devoted to principal and interest payments. All tax calculations assume a joint return with four exemptions. Current tax law calculations are based on values for personal exemptions, standard deduction or zero bracket amount, and tax brackets projected for 1986.

^{2/}Tax savings is computed as the difference in tax liability between a homeowner and renter with the same AGI, the same number of exemptions, and the same amount of non-housing itemized deductions. Tax savings decline under the Reagan and Rostenkowski proposals due to lower marginal tax rates, effective elimination of property tax deductibility under both proposals, and increases in the zero bracket amount or standard deduction. Since the ZBA or standard deduction under both the Reagan and Rostenkowski proposals exceed the amount of non-housing deductions, itemized deductions in excess of the ZBA or standard deduction are less than the amount of mortgage interest. As a result tax savings is less than 15 percent of mortgage interest.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Total Impact of Reagan Proposal on After-Tax Homeownership Costs
and Home Value by State

State	Average Home Price (Dollars)	Average Property Tax Rate (Percent)	Average Increase in After-Tax Homeownership Cost (Percent-Dollars)		Average Decline In Home Value (Percent-Dollars)	
Alabama	\$56,500	0.42%	5%	\$260	-5%	\$-2,800
Alaska	136,700	1.06	11	1,180	-9	-12,000
Arizona	85,000	0.71	12	890	-11	-9,400
Arkansas	57,800	1.29	7	400	-7	-4,000
California	121,700	1.05	8	830	-8	-9,400
Colorado	90,700	0.95	14	1,100	-13	-11,300
Connecticut	118,800	1.60	13	1,270	-11	-13,500
Delaware	79,600	0.76	14	990	-13	-10,300
District of Columbia	133,600	1.17	11	1,150	-10	-12,800
Florida	76,100	0.92	12	790	-11	-8,100
Georgia	83,700	1.16	12	930	-11	-9,300
Hawaii	158,300	0.60	18	1,980	-15	-23,600
Idaho	58,100	1.02	8	440	-8	-4,500
Illinois	95,800	1.72	14	1,240	-12	-11,800
Indiana	70,800	1.23	12	770	-11	-7,600
Iowa	68,800	1.67	11	740	-10	-7,000
Kansas	68,800	1.00	10	620	-9	-6,300
Kentucky	66,100	1.02	10	600	-9	-6,000
Louisiana	72,500	0.14	10	620	-10	-6,900
Maine	67,000	1.52	11	740	-11	-7,200
Maryland	94,200	1.38	13	1,120	-12	-11,000
Massachusetts	101,300	1.85	10	960	-9	-9,000
Michigan	79,900	2.68	16	1,300	-14	-11,200
Minnesota	81,300	0.85	15	1,100	-14	-11,000
Mississippi	61,400	0.82	8	350	-6	-3,700
Missouri	64,100	1.09	8	500	-8	-5,100
Montana	46,600	1.17	8	350	-8	-3,500
Nebraska	62,700	2.12	9	600	-9	-5,500
Nevada	93,800	0.68	13	970	-11	-10,200
New Hampshire	87,100	2.23	17	1,470	-15	-13,300
New Jersey	110,000	2.54	12	1,270	-10	-11,200
New Mexico	60,500	0.90	4	230	4	-2,300
New York	95,300	2.66	13	1,260	-12	-10,900
North Carolina	65,800	0.96	9	550	-9	-5,600
North Dakota	70,800	1.26	8	560	-8	-5,500
Ohio	84,800	1.15	16	1,230	-15	-12,300
Oklahoma	73,800	0.89	11	750	-11	-7,700
Oregon	68,700	2.27	12	840	-11	-7,500
Pennsylvania	58,100	1.71	9	540	-9	-5,100
Rhode Island	86,600	2.01	18	1,460	-16	-13,500
South Carolina	78,100	0.85	12	830	11	-8,600
South Dakota	56,200	1.75	9	540	8	-4,600
Tennessee	71,900	1.17	18	1,460	-6	-4,600
Texas	85,300	1.36	12	830	12	-10,500
Utah	85,800	0.97	9	480	-9	-8,000
Vermont	65,500	1.67	7	460	10	-6,200
Virginia	91,900	1.28	14	1,070	-13	-11,900
Washington	80,900	1.03	10	790	-13	-10,700
West Virginia	54,400	0.68	8	410	-8	-1,300
Wisconsin	87,600	1.90	18	1,450	-15	-13,500
Wyoming	60,500	0.45	6	330	-6	-3,500

SOURCE: NATIONAL ASSOCIATION OF REALTORS

Impact of Tax Revision on Federal Tax Burden of Homeowner^{1/}

	Current Law		Administration Proposal		Rostenkowski Proposal	
	Homeowner	Renter	Homeowner	Renter	Homeowner	Renter
Income						
Employer paid health premiums	\$36,000	--	\$36,000	\$36,000	\$36,000	\$36,000
Second earner exclusion	--	--	300	300	--	--
Miscellaneous deductions	-594	--	--	--	--	--
Adjusted Gross Income	35,406	--	36,195	36,195	36,000	36,000
Exemptions	-4,320	--	-8,000	-8,000	-6,000	-6,000
Itemized Deductions						
Mortgage interest	-8,840	--	-8,840	--	-8,840	--
Real Property taxes	-1,216	--	--	--	--	--
Other taxes:						
S&L Income Taxes	-1,296	--	--	--	-1,000	-1,000
S&L Sales Taxes	-504	--	--	--	--	--
Personal Property taxes	-36	--	--	--	--	--
Other	-36	--	--	--	--	--
Other interest	-1,080	--	-1,080	-1,080	-1,080	-1,080
Miscellaneous Deductions	-488	--	--	--	-105	-105
All other	-1,130	--	-1,130	-1,130	-1,030	-1,130
Subtotal	-14,606	--	-13,050	-2,210	-12,155	-3,315
Less: ZBA	3,670	--	4,000	4,000	--	--
Total Itemized Deductions	-10,936	--	-7,050	0	-12,155	--
Standard Deduction	--	--	--	--	--	-7,000
Taxable Income	20,150	--	21,145	28,195	17,845	23,000
Tax Liability before credits	2,398	--	2,572	3,629	2,677	3,450
Child care credit	-285	--	-285	-285	-285	-285
Tax liability	\$ 2,113	--	\$ 2,287	\$ 3,344	\$ 2,392	\$ 3,165

1/ Table assumes a joint return with four exemptions. Household consists of two earners with shares of total income split two-thirds, one-third. Mortgage interest based on an \$85,000 home financed with a 20 percent downpayment and an 80 percent, 30-year, fixed-rate mortgage loan at 13 percent. Property taxes are 1.43 percent of home value. Values for all other itemized deductions and the child care credit are averages for taxpayers at the \$36,000 income level as reported in the 1983 Statistics of Income--Individual Tax Returns.

Source: NATIONAL ASSOCIATION OF REALTORS®.

Depreciation Allowances for Structures Per \$1,000 of Investment 1/

Years	Current Law (19 years)				CCRS (Reagan)				Rostenkowski			
	Cumulative		Cumulative		Cumulative		Cumulative		Cumulative		Cumulative	
	ACRS2/	Present Value	St. Line	% Diff. from Current Law	ACRS2/	Present Value	St. Line	% Diff. from Current Law	ACRS2/	Present Value	St. Line	% Diff. from Current Law
1	\$ 40	\$ 26		-56.5%	\$ 20		-23.1%	-63.0%	\$ 17		-34.6%	
2	124	71		-54.8	56		23.3	-62.9	46		-37.0	
3	187	114		-52.4	89		-21.9	-61.5	72		-36.8	
4	236	150		-50.0	118		-21.3	-59.7	95		-36.7	
5	277	183		-48.0	144		21.3	-58.1	116		-36.6	
6	309	211		-45.7	169		-19.9	-56.6	134		-36.5	
7	335	237		-42.7	192		-19.0	-55.2	150		-36.7	
8	356	259		-40.2	213		-17.8	-53.9	164		-36.7	
9	373	279		-37.8	232		-16.8	-52.8	176		-36.9	
10	387	296		-35.1	251		-15.2	-51.4	188		-36.5	
11	399	312		-32.8	268		-14.1	-50.6	197		-36.9	
12	410	325		-31.0	283		-12.9	-49.8	206		-36.6	
13	420	338		-29.0	298		-11.8	-49.0	214		-36.7	
14	428	348		-27.1	312		-10.3	-48.4	221		-36.5	
15	436	358		-25.7	324		-9.5	-47.9	227		-36.6	
16	443	366		-24.2	336		-8.2	-47.6	232		-36.6	
17	449	374		-22.7	347		-7.2	-47.2	237		-36.6	
18	454	380		-21.4	357		-6.1	-46.9	241		-36.6	
19	459	386		-20.0	367		-4.9	-46.8	244		-36.8	
20	461	389		-18.7	375		-3.6	-46.2	248		-36.2	
21	na	na		na	384		na	na	251		na	na
22	na	na		na	391		na	na	253		na	na
23	na	na		na	398		na	na	255		na	na
24	na	na		na	405		na	na	257		na	na
25	na	na		na	411		na	na	259		na	na

Depreciation Allowances for Structures Per \$1,000 Investment 1/

Current Law (19 years)				CCRS (Reagan)				Rostenkowski			
Years	Cumulative Present Value		St. Line	Cumulative Present Value		St. Line	% Diff. from Current Law	Cumulative Present Value		St. Line	% Diff. from Current Law
	ACRS ^{2/}							ACRS ^{2/}			
26	na	na	na	\$416	na	na	na	\$261	na	na	na
27	na	na	na	422	na	na	na	262	na	na	na
28	na	na	na	427	na	na	na	263	na	na	na
29	na	na	na	429	na	na	na	264	na	na	na
30	na	na	na	na	na	na	na	265	na	na	na
31	na	na	na	na	na	na	na	266	na	na	na

1/First year allowance assumes an asset is placed in service by a calendar year taxpayer on July 1, without regard to the mid-month convention. Cumulative present value calculation assumes a real interest rate of 8 percent and an inflation rate of 3 percent.

2/ACRS is 175 percent declining balance with optional switching to straight line.

na-Not applicable.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®